

STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
PUBLIC UTILITIES COMMISSION

IN RE: ISLAND HI-SPEED FORM OF :
REGULATION AND REVIEW OF RATES : DOCKET NO. 3495

ORDER

I. Overview

On February 27, 2003, the Public Utilities Commission (“Commission”) initiated the instant docket to review Island Hi-Speed Ferry, LLC’s (“IHSF”) form of regulation and to investigate the reasonableness of its current rates and charges.¹

On March 26, 2003, Interstate Navigation Company d/b/a The Block Island Ferry (“Interstate”) filed a Motion for Full Party Intervention.² Also, on March 26, 2003, the Town of New Shoreham (“Town”) filed a Motion to Intervene. On April 9, 2003, IHSF filed Objections to both Motions.³

On April 24, 2003, at its Open Meeting, the Commission denied Interstate’s and the Town’s respective Motions to Intervene finding that neither party has a direct interest in the form of regulation or rates for IHSF.⁴ Additionally, the Commission noted that when Commission Docket No. 2802 (the initial case setting IHSF’s form of regulation

¹ Minutes of the Commission’s February 27, 2003 Open Meeting. IHSF is authorized to operate a seasonal high speed ferry service between termini in Galilee and Block Island. In Docket No. 2802, the Commission approved a different form of regulation for IHSF than for Interstate Navigation. In doing so, the Commission noted that it was utilizing a unique regulatory treatment. The Commission also asserted its jurisdiction to deviate from any single regulatory approach and to make pragmatic adjustments as appropriate to a particular set of circumstances. In approving the Commission’s approach, the Rhode Island Supreme Court stated that “[n]o particular formula binds the Commission in formulating its rate decision; the sole requirement is that the ultimate rate be fair and reasonable.” In Docket No. 2802, the Commission approved a rate with a revenue cap for IHSF, whereas Interstate Navigation still had (and has) rates based on a traditional rate base/rate of return methodology. Interstate is the lifeline service and IHSF provides a purely discretionary, amenities-only based service. IHSF does not transport vehicles or freight. See Order No. 15816 (issued March 31, 1999).

² Interstate is authorized to operate a year-round “lifeline” ferry service between termini in Galilee and Block Island.

³ The Certification of Service was dated April 4, 2003.

and rates)⁵ was reviewed by the Rhode Island Supreme Court, the Court indicated that although the decision allowing these parties to intervene in that case was not clearly wrong, the wisdom of that decision was questionable.⁶

After reviewing the parties' pre-filed testimony and taking evidence at a public hearing held on July 9, 2003, the Commission determined that the appropriate form of rate regulation for IHSF is a price floor with no revenue or profit cap. The current rate is based on the current passenger rates that were originally based on the IHSF business plan filed in Docket No. 2802. The Commission found that IHSF's rates should not be based on Interstate's rates.

II. Pre-Filed Testimony

On May 30, 2003, IHSF submitted the pre-filed testimony of its witness, Lawrence R. Kunkel, an economist. On June 23, 2003, the Division submitted the pre-filed testimony of its witness, Dr. John Stutz, a Division consultant. Both parties rejected a traditional rate base/rate of return form of regulation for IHSF.

According to Mr. Kunkel, a traditional form of regulation is not appropriate because of the "profoundly different character of the services supplied to the market by IHSF and Interstate." He noted that rate base/rate of return regulation is traditionally used where competition is limited or non-existent and where the potential for direct

⁴ See Order No. 17452 (issued May 9, 2003). The Town of New Shoreham is currently involved in an appeal from the Commission's Order. In re: Island Hi-Speed Ferry, LLC, Case No. 2003-0214-MP.

⁵ See Order No. 15816 (issued March 31, 1999), pp. 58-63 (noting that there is ample precedent where the Commission has used a variety of ratemaking methodologies, including price cap plans, price stabilization plans, and further noting that the Commission may wish to employ other methodologies in the future, including, potentially, rate caps). In reviewing the Commission's determination of the appropriate ratemaking approach utilized in Docket No. 2802, which included revenue caps, the Supreme Court reiterated that "[n]o particular formula binds the Commission in formulating its rate decision; the sole requirement is that the ultimate rate be fair and reasonable." (citations omitted). In re Island Hi-Speed Ferry, LLC, 746 A.2d 1240, 1245-46 (R.I. 2000).

⁶ In re Island Hi-Speed Ferry, LLC, 746 A.2d at 1245-46 (R.I. 2000).

competitive market entrance is remote.⁷ Likewise, Dr. Stutz argued that “in general, government does not regulate the prices for, or revenues from, non-essential services.”⁸

However, both parties also reject complete deregulation of IHSF because, where a competitive overlap exists, there is a duopoly market structure. According to Mr. Kunkel, “[d]uopolistic market structures, by their nature, present the opportunity for anti-competitive collusive behavior on the part of the market players.”⁹ Similarly, Dr. Stutz argued that some form of regulation is necessary to protect the lifeline service.¹⁰ Dr. Stutz noted that price regulation is normally utilized when there is concern that price cutting which might harm competitors is likely to occur, and that regulation may include the setting of a price floor or cap.¹¹

In this case, IHSF has argued in favor of a price floor to protect against anti-competitive behavior. The Division has also argued in favor of a price floor in order to protect the lifeline service from the potential for IHSF to set artificially low prices. Both parties believe that the current price floor as set forth in the Division Certificate is appropriate to adequately protect the lifeline service.¹² However, while arguing that the current differential in price between IHSF and Interstate is appropriate, IHSF stressed that it is not proposing a fixed differential be a part of the regulation of IHSF.¹³

In support of IHSF’s position for a ticket price floor for passenger ridership only, Mr. Kunkel indicated that his principal reasons were as follows:

(1) that IHSF is a non-essential, non-lifeline, discretionary, amenities-based transportation service; (2) that IHSF and Interstate Navigation are indirect

⁷ IHSF Ex. 1 (Pre-filed Testimony of Lawrence R. Kunkel), pp. 3-4.

⁸ Div. Ex. 1 (Pre-filed Testimony of Dr. John Stutz), p. 7.

⁹ IHSF Ex. 1, p. 3.

¹⁰ Div. Ex. 1, pp. 6-7.

¹¹ *Id.* at 7-8.

¹² *Id.* at 7; IHSF Ex. 1, p. 4.

¹³ IHSF Ex. 1, p. 4.

competitors; (3) that the role each firm plays in the market is vastly differentiated; (4) [that] the proposed form of regulation preserves the spirit of Division Docket 98-MC-16, which is meant to provide a rate differential sufficient to protect the essential lifeline service (Interstate Navigation) from the potential of “a massive crossing of the dock”; and, (5) that IHSF faces potential competition from new market entrants.¹⁴

Additionally, the Division argued that the Commission should reject the continuation of a revenue cap. Dr. Stutz noted that in Order No. 15816, the Commission indicated that “there is no legal requirement that rates be set solely on the basis of the applicant’s revenue requirements or revenue projections or even on the basis of cost of service/rate of return; only that the rates set be just and reasonable.”¹⁵ Referring to Bell Atlantic-Rhode Island (“BA-RI”), Dr. Stutz noted that the Commission allowed the Company to set the prices or rates (through price caps) for various discretionary products and services without a requirement that any excess earnings be returned to the ratepayers. Dr. Stutz noted that the Commission allowed this even though, at the time, BA-RI was the monopoly provider of those products and services without a viable alternative provider in the market. Here, IHSF is the competitor, offering an alternative to the amenities based portion of the lifeline service.¹⁶

III. Hearing

Following notice, a public hearing¹⁷ was conducted on July 9, 2003, at the Commission’s offices, 89 Jefferson Boulevard, Warwick, Rhode Island. The following appearances were entered:

¹⁴ Id. at 4-5.

¹⁵ Div. Ex. 1, pp. 7-8.

¹⁶ Id.

¹⁷ At the time of the hearing, Interstate and the Town of New Shoreham had challenged the Commission’s decision not to grant intervention in the instant case. The Rhode Island Supreme Court had granted the parties’ petitions for a writ of certiorari. On the day of the hearing, the Court granted a consent motion to remand the case back to the Commission for purposes of conducting the hearing. After Commission counsel spoke with a Court Clerk, the Commission sent the case file back to the Court. Although the

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Special Assistant Attorney General

FOR COMMISISON: Cynthia G. Wilson, Esq.
Senior Legal Counsel

At the hearing, Mr. Lawrence Kunkel testified on behalf of IHSF. Mr. Kunkel agreed to define predatory pricing as pricing below the marginal cost of supplying the service. Also, Mr. Kunkel defined marginal cost as the cost incurred after all the fixed costs of service are incurred. He also stated that an anti-trust price floor would only cover the fixed costs. In addition, Mr. Kunkel agreed that setting a price floor is not the same as setting a rate, and agreed the Commission could establish a price floor based on an economic concept rather than a dollar amount.¹⁸

Mr. Kunkel emphasized that there should be no linkage between the price floor for IHSF and the rates for Interstate.¹⁹ He also stated that IHSF's current \$26 rate has not led to a significant loss of customers for Interstate.²⁰ He agreed that an anti-trust price floor for IHSF would be below \$26. Mr. Kunkel also stated that a price floor could be set based on a traditional rate of return cost of service approach which would probably be below \$26. Mr. Kunkel acknowledged that only the Commission has the authority to set

Commission's decision in the matter of the form of regulation for IHSF followed that action, the decision is wholly separate from the issue upon which the writ of certiorari was granted, namely, the denial of intervention. Furthermore, Interstate has withdrawn its petition for a writ of certiorari. It is the Commission position that if the denial of intervention is sustained, the Town of New Shoreham's interests were not harmed by this decision. Additionally, if the denial of intervention is overruled, the Commission assumes the entire matter, including the determination of the appropriate form of regulation of IHSF will be remanded to the Commission with further direction and for further proceedings.

¹⁸ Tr. 7/9/03, pp. 35-37, 47.

¹⁹ However, Mr. Kunkel expressed concern regarding the stability of the competitive market if Interstate's rates were to come within \$10 of Hi-Speed's rates. Id.

²⁰ Id., pp. 39-42.

rates. Mr. Kunkel argued that there should be no revenue cap on IHSF, and if in the past, IHSF exceeded the revenue-cap then IHSF should retain the revenues.²¹

Dr. John Stutz testified on behalf of the Division. He agreed that a price floor could be established based on an economic concept rather than a fixed rate. He also agreed that a price floor could be based on either anti-trust or traditional rate of return cost of service. However, he explained the problems of utilizing either approach for establishing a price floor for IHSF. Dr. Stutz explained that the \$26 price floor was based on IHSF's business plans and did not harm the lifeline service.²² Dr. Stutz stated there is "no automatic linkage" between IHSF's price floor and Interstate's rates. Mr. Stutz explained that if Interstate was losing a "massive" number of customers to IHSF then IHSF's price floor would need to be examined.²³ Dr. Stutz stated there is a "loose linkage" between IHSF's price floor and Interstate's rates. Dr. Stutz explained that with a price floor IHSF could change their rates upward by filing a tariff with the Commission and have it approved without a hearing.²⁴ Dr. Stutz stated that the Commission could exempt IHSF's bicycle rates from the price floor.²⁵

IV. Commission Findings

The Commission is statutorily mandated to set just and reasonable rates for public utilities. However, the methodology used to establish just and reasonable rates is a matter left to the Commission's discretion and expertise.²⁶ In the past, the Commission has struggled to determine the appropriate form of regulation and rates for IHSF. To some

²¹ Id., pp. 47, 51, 53-54.

²² Id., pp. 65-68.

²³ Dr. Stutz also expressed concern with regard to the price differential if Interstate's rates are to come within \$10 of IHSF's rates. Id.

²⁴ Id., pp. 70-72, 85, 104-105.

²⁵ Id., pp. 95-96.

²⁶ In re Island Hi-Speed Ferry, LLC, 746 A.2d 1240, 1245-46 (R.I. 2000).

extent, the Commission has attempted to regulate IHSF as it would other traditional utilities by fixing a specific rate accompanied by a revenue cap. After a full season of service by IHSF, the Commission determined it was appropriate to review IHSF's form of regulation and rates. Upon a review of the record, the Commission determines that IHSF is not the kind of public utility that requires a traditional form of regulation consisting of a rate of return and a cost of service.

IHSF is not a traditional public utility because it does not, nor is it required to, provide a lifeline service. IHSF's service is purely discretionary in that it is a passenger and bicycle only service. It does not transport passenger cars. It is a matter of choice for consumers to utilize IHSF during the summer season to visit Block Island. In contrast, Interstate provides year-round lifeline service that is necessary for residents of the Town of New Shoreham. Interstate also transports passenger cars and freight. Regardless, the rates and charges for the lifeline service are not at issue in this case.

IHSF resembles a competitive local exchange carrier ("CLEC") in the telecommunications sector because consumers have the discretion to choose a CLEC's service. Thus, the Commission allows CLECs to set whatever rates they choose as long as the rates are not anti-competitive. Similarly, the Commission determined that IHSF should have flexibility to set its own rates as long as the rates are not anti-competitive. Based on the evidence, the Commission determined that IHSF's current rates for passengers, which is based on IHSF's own business plan, is an appropriate price floor that will not harm the competitive market. No evidence was found to demonstrate that IHSF's current rates have caused Interstate to lose a significant number of customers or that IHSF is violating anti-trust laws. In fact, IHSF has been providing service for nearly

two and one-half years and Interstate has not filed for a rate increase. Instead, Interstate has expended time on litigation directed against IHSF. If there ever is a massive defection of customers from Interstate to IHSF that actually affects the lifeline service, as a direct result of IHSF's activities and not the activities of Interstate, the Commission would consider revisiting IHSF's price floor. However, the price floor ordered in this case is not linked to Interstate's rates. If Interstate's rates were to increase due to factors such as fuel costs or legal fees, IHSF's price floor will not automatically need to be increased. This approach will incent both IHSF and Interstate to be cost-efficient as they compete for the discretionary market of summer season visitors to Block Island.

Regulation is merely a substitute for the competitive market in setting prices. A price floor for IHSF based on its current passenger rates is sufficient regulation for ferry service to Block Island for day-trippers during the summer tourist season.

Accordingly, it is

(17619) ORDERED:

1. That the appropriate form of regulation for Island Hi-Speed Ferry is to set its rates based on a price floor with no revenue or profit cap imposed.
2. That the appropriate price floor is the current passenger rates that were originally based on Island Hi-Speed Ferry's business plan filed in Docket No. 2802.
3. That bicycle rates shall be set at the discretion of Island Hi-Speed Ferry.
4. That if Island Hi-Speed Ferry has collected in excess of the previously determined revenue cap, it may retain those funds.
5. That Island Hi-Speed Ferry shall comply with all other direction of the Commission as contained herein.

EFFECTIVE AT WARWICK, RHODE ISLAND ON SEPTEMBER 11, 2003,
PURSUANT TO AN OPEN MEETING DECISION. WRITTEN ORDER ISSUED ON
NOVEMBER 25, 2003.

PUBLIC UTILITIES COMMISSION

Elia Germani, Chairman

Kate F. Racine, Commissioner

Robert B. Holbrook, Commissioner